were reamed out by their superiors if they tried to block the bad loans. This dynamic is an independent reason why recordkeeping at the nonprime lenders is often horrific.

Finally, lenders like Bank of America, Citibank, and WaMu acquired major nonprime lenders that were notorious for their predatory and fraudulent lending. These banks then often place the employees they obtained via these mergers in charge of loan servicing. It was utterly predictable that they would continue their unethical practices when they functioned as loan servicers—particularly because the alternative would be to admit that their loan servicing files were a shambles. Far better to simply file false affidavits and claim that everything was in order—which is exactly what many of the largest loan servicers did ten thousand times a month.

This is one of the reasons that my colleague Randy Wray and I have called for Bank of America to be placed promptly into receivership. A minor blue collar thief can go to prison for life under some ''three strikes'' laws—a huge bank doesn't even suffer a major loss of reputation when it commits a hundred thousand felonies. The U.S. now has its own version of crony capitalism that has produced recurrent, intensifying financial crises—just as crony capitalism does in many nations. The difference is that our economy is so massive that when we have a crisis many nations suffer. When a nation's elites are able to cheat with impunity the result is always disastrous.

What should President Obama and Congress be doing right now to regulate the banks in a meaningful and fair way?

Economists, white-collar criminologists, and regulators agree that the key is to stop, or at least limit, perverse incentives. Intensely criminogenic environments lead to epidemics of control fraud. There are six key components of what makes an environment dangerously criminogenic.

A. Size matters. A tremendous bubble in the price of persimmons won't harm the U.S. economy. Real estate bubbles, by contrast, could cause losses that were a large percentage of the U.S. GDP. That's how you get a Great Recession. Accounting control frauds are particularly dangerous because of they can grow so rapidly and because they tend to cluster in the assets that are most ideal for accounting fraud. The combination of clustering and rapid growth means that epidemics of accounting control fraud can hyper-inflate massive bubbles. Akerlof & Romer and my work have long warned specifically about this danger.

The federal regulatory and prosecutorial agencies are filled with ''chief economists,'' but there are no ''chief criminologists'', no comprehensive federal data on the most destructive white-collar crimes, and virtually zero federal funding for research into the elite financial frauds that have caused trillions of dollars of losses in the U.S. over the last 20 years. We need to do the opposite—hire chief criminologists, keep comprehensive data on the worst frauds, and fund research so that we can actively identify the industries at greatest risk of developing the next epidemic of control fraud. (And this needs to be done not only for banks. The FDA, for example, needs help in spotting frauds that maim and kill.) We then need to act, quickly, to stop those epidemics in their tracks. We did this in 1990–91 as S&L regulators when we stopped the rapid spread of ''liar's'' loans at several California S&Ls.

B. Deregulation, desupervision (the rules remain in place but the anti-regulators running the regulatory agencies don't enforce them) and de facto decriminalization (the three ''de's'') produce the ideal criminogenic environment. The regulators are the ''cops on the beat'' when it comes to sophisticated frauds. If you remove the cops of the beat, cheaters prosper and honest businesses are driven from the markets. President Obama largely kept in place the failed anti-regulators he inherited from President Bush. Indeed, Obama promoted Geithner—an abject failure as a regulator in his capacity as President of the NY Fed—and renominated Bernanke, an even greater failure. Obama should fire Attorney General Holder and Treasury Secretary Geithner and ask Chairman Bernanke to resign. He should appoint regulators and prosecutors who have a track record of success.

C. Executive compensation. There is a consensus that executive compensation should be based on long-term (real) profitability. In reality, executive compensation is overwhelmingly based on short-term reported income. (It's actually worse than that—if the short-term results are bad corporations commonly gimmick the compensation system to reward the senior officers' failures.) Everyone agrees that short-term reported accounting income is easy to inflate through accounting fraud and virtually everyone agrees that this creates strong, perverse incentives. Since, the current crisis began, the percentage of bonus compensation based on short-term reported income has increased—executive compensation has become more perverse.

Note that executive compensation also allows the CEO to convert the firm's assets to his personal benefit using seemingly normal corporate mechanisms, which makes it far harder to prosecute the CEO for looting the firm. All bonus income that takes annual income above $200,000 should be paid after five years—if the firm's reported income turns out to be real. There should be ''clawback'' provisions to recover bonuses even after those five years if they were based on corporate income inflated by fraud or ''window dressing.''

D. Professional compensation is perverse. Accounting control frauds deliberately exploit this to create the Gresham's dynamic that allow them to suborn the outside professionals—appraisers, attorneys, auditors, and rating agencies—who are supposed to prevent fraud, but who actually become the frauds' most valuable allies. Honest professionals don't get hired, the unethical professionals prosper. This process creates ''echo'' epidemics of control fraud. Fraudulent nonprime lenders, for example, shaped financial incentives to be perverse to create endemic appraisal and loan broker fraud. The banks should not be able to hire or fire the appraisers, credit rating agencies, and auditors—except for fraud or serious incompetence. Those professionals can only be truly independent if they are assigned to work for the bank by a truly independent entity.

E. The federal government has permitted banks to inflate their reported incomes and ''net worth'' for the purpose of evading the mandatory statutory duty under the Prompt Corrective Action (PCA) law to close deeply insolvent banks. Congress, at the behest of the Chamber of Commerce, the banking trade associations, and Chairman Bernanke, successfully extorted the Financial Accounting Standards Board (FASB) to scam the accounting rules so that the banks could fail to recognize on their accounting reports over a trillion dollars in losses.

When banks understate their losses massively they, by definition, overstate their net worth massively. The PCA's provisions kick in when net worth falls, so the accounting lies have gutted the PCA. The accounting lies also allow the banks to (once again) report high fictional income when they are experiencing large, real losses. This accounting scam allows the bank executives to collect hundreds of billions of dollars in bonuses. We should end the accounting scam and enforce the PCA.

We are also secretly subsidizing banks and hiding their losses through massive loans from the Federal Reserve backed by toxic collateral. We should end those subsidies and force them to post good collateral.

F. Systemically dangerous institutions (SDIs) have often become far larger and more dangerous since the crisis. The administration is taking no serious steps to protect us against the roughly 20 SDIs even though the administration claims that when one of them next fails it is likely to cause a global financial crisis. Why are we juggling 20 live grenades? The only question is when the next pin will drop out and we'll be blown up.

The good news about the SDIs is that they have reason to exist. They would be far more efficient if they shrank in size to levels at which they no longer endangered the global economy. We should do three things about the SDIs. One, stop their growth—immediately. Two, order them to shrink over the next five years to a size at which they no longer are SDIs. Let them decide what operations to sell. Three, intensively regulate the SDIs during those five years. That includes placing any insolvent SDIs in ''pass through receiverships''—which does not prompt crises.

If there were one questionable banking practice that you could stop today, what would that be?

The foreclosure frauds.

You have spent decades examining what goes on in banks. Do think that bankers, either through culture or genetics, are ethically-challenged?

When you allow a *Gresham's dynamic* to operate and when entry to an industry is easy (as it was for loan brokers and mortgage bankers), you concentrate the least ethical business leaders in the industry that is most criminogenic. In the last decade, banking has been severely criminogenic in the U.S. and much of the world. The unethical banking leaders became dominant. Their banks, which followed the four-part recipe for maximizing fictional accounting income, became far larger and drew the greatest praise from the business boosters than dominated the financial media. They made their reputations and their fortunes through fraud.

PERSONAL EXPLANATION

HON. KAY GRANGER

OF TEXAS

IN THE HOUSE OF REPRESENTATIVES

Wednesday, December 22, 2010

Ms. GRANGER. Madam Speaker, on rollcall Nos. 662 and 661, I was absent from the House. Had I been present, I would have voted ''no.''

THANK YOU FOR ALLOWING ME TO SERVE

HON. CAROLYN C. KILPATRICK

OF MICHIGAN

IN THE HOUSE OF REPRESENTATIVES

Wednesday, December 22, 2010

Ms. KILPATRICK of Michigan. Dear Madam Speaker, as I leave Congress as the people's representative for the 13th Congressional District of Michigan, I thank God, who is the head